

Review 33

FRY: Main economic indicators

	$\frac{\theta \text{ 2001}}{\theta \text{ 2000}}$	VIII 2002	$\frac{\text{VIII 2002}}{\text{VII 2002}}$	$\frac{\text{VIII 2002}}{\text{VIII 2001}}$	$\frac{\text{I-VIII 2002}}{\text{I-VIII 2001}}$
GDP growth rate*	5.5%	...	...	...	...
Industrial production	0.0%	...	-2.9%	0.8%	0.1%
Montenegro	-0.7%	...	-11.3%	5.2%	-5.1%
Serbia	0.1%	...	-2.3%	0.6%	0.4%
Central Serbia	-4.0%	...	-3.5%	5.1%	0.6%
Vojvodina	9.2%	...	0.6%	-7.7%	-0.1%
Average nominal net wage - Serbia, YuD	125%**	9,944	6.4%	46.2%	17.6%***
Nominal gross wage - Serbia, YuD¹	...	14,317	6.4%	46.1%	17.9%***
Real growth in nominal net wage - Serbia, %²	16.6%**	...	6.3%	29.4%	9.3%***
Ratio of consumer's basket to average net wage	...	1.2	0.0%	-31.0%	...
Unemployment rate- Serbia, registered³	4.4%	30.1%	4.1%	10.6%	5.9%
Current account, USD million	-87.1%	...	...	...	...
Trade balance, USD million	-58.5%	-258	-8.0%	-60.3%	-9.4%
Export USD million	10.5%	187	-8.9%	25.5%	16.0%
Montenegro	10.3%	7	2.4%	-62.7%	-10.5%
Serbia	10.4%	181	-8.7%	37.4%	19.0%
Import, USD million	30.3%	467	-2.7%	36.8%	17.1%
Montenegro	49.3%	27	-35.1%	-41.6%	-24.5%
Serbia	27.9%	438	0.4%	50.1%	24.0%
Money supply (M₁), in YuD bn (end of period)	109.8%	104.88	8.3%	...	...
Cash	103.4%	37.45	6.9%	...	...
Deposit	113.7%	67.31	8.9%	...	...
Real money supply, DEM million (end of period)	94.1%	...	...	...	...
NBY hard curr. reserves, USD mil. (end of period)	123.0%	2098	13.3%	132.7%	135.8%
Discount rate - monthly level	-26.65%	0.75%	0.0%	-51.0%	...
Market interest rate - monthly level	-18.40%	1.69%	0.6%	-49.1%	...
Retail prices - Serbia⁴	91.8%	...	0.9%	16.0%	21.1%
Consumer prices- Serbia⁴	93.3%	...	1.3%	12.6%	18.5%
Producer prices - Serbia	87.8%	...	0.4%	8.9%	10.0%
Medium exchange rate (YuD/EUR) - average	16.5%	60.92	0.2%	2.2%	2.0%

*Preliminary figures

** According to the previous methodology.

*** The figures refer to growth in wages in August 2002 relative to December 2001.

¹ By the gross wage methodology applied as of June 1, 2001..

² Deflator is cost-of-living index

³ The figures include the employed in socially-owned sector, private sector and SMEs

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Macroeconomic Review

PRODUCTION AND EXPORT GROWTH AND INCREASE OF THE PURCHASING POWER OF CITIZENS

Prices

Retail prices in Serbia without Kosovo and Metohija in September 2002 were up by 0.9%. Retail prices increased by 21.1% in the first nine months of 2002 year-to-year. The growth of the index of prices in September resulted from the increase in prices of agricultural products, owing to the reduced supply of domestic fresh vegetables, which further affected the increase in the price of food products. Retail prices of industrial products in September were up by 0.4% month-on-month, while retail prices of services rose by 1.6%.

A cumulative growth in prices in the first quarter of 2002 was 2.4%, which doubled in the second quarter, reaching 10% at the end of September. Cumulative growth in prices of 9% that was targeted by a set of economic measures for the end of June was statistically registered as late as the previous month. It is clear now that the 20% growth rate in prices projected for the year-end is an overestimate. If ongoing reforms continue to progress as thus far, the cumulative inflation rate in the following three years, measured by the ratio of December of current to the December of the previous year, should achieve a one-figure value, approaching the real GDP growth rate in 2005.

Industrial producer prices were stagnant in the first six months of this year, which resulted in a steady growth rate of these products at a level of 5% relative to the last year's average. Growth in production costs of electricity, gas and water in July affected industrial producer prices in the previous two months, but at the

same time prompted the recovery of production in all three sectors of the industry.

After having grown at a faster pace than retail prices last year, consumer prices this year follow the dynamics of retail prices. In the course of September, consumer prices grew at a faster pace than retail prices, which resulted in the average monthly growth rate of 1.3%. Overall growth of consumer prices was mainly contributed to by the increase in prices in the group comprising education, culture and entertainment (2.9%). In the last quarter, prices in this group have been registering continuous growth.

After the decrease of several months, prices of food products in the group comprising nutrition registered a growth of 1.9% in September, but, compared with December 2001, these prices are still lower by 0.9%. Liberalization of prices of a major portion of products that were under control from this group, as well as temporary sales tax relief had predominantly influenced decelerated growth and the maintenance of prices of food products under the level registered in December 2001. The price of housing (rent, fuel and light, and household furniture) in September were down by 0.1% month-on-month, but compared to the end of last year, these prices cumulated the highest growth, thus mostly burdening home budgets.

CHART

Retail Prices, Industrial Producer Prices And Consumer Prices (average 2001 = 100)

- *retail prices*
- *industrial producer prices*
- *consumer prices*

Trends in Wages and Pensions and the Purchasing Power of Citizens

Wages and Pensions

The average net wage in Serbia without Kosovo and Metohija in August 2002 was YuD 9,994, while the average gross wage was YuD 14,317. Nominal net wage in August 2002 was up by 6.4% month-on-month, or by 46.2% year-to-year.

The consumer price index was up by 0.1% in August relative to the previous month; thus, the average net wage increased by 6.3% in real terms. The consumer price index in August rose by 13% year-to-year; consequently, the average net wage in August 2002 increased by 29.4% year-to-year. Real growth of the average net wage in August 2002 was 9.3%, compared with December 2001.

The consumer basket for a four-member family in August 2002 was valued at YuD 11,733, which is up by 2.85% relative to the previous month, while the ratio of the value of consumer basket to the nominal net wage remained unchanged (1.2). This ratio is evidently decreasing, especially bearing in mind that it amounted to 1.7 in August 2001.

The average net wage in the economy in August 2002 was YuD 9,336, while in the non-economic sector, it was slightly higher, amounting to YuD 11,776. In real terms, the average net wage in the economy in August increased by 4.4% month-on-month, while in the non-economic sector, it rose by 11.2%.

With regard to sectors, the highest average nominal net wage was paid out in the sector of financial mediation, where it was up by 82% relative to the total average nominal net wage, while the hotels and restaurants sector registered the lowest net wage, which was down by 31.9% compared with the total average net wage.

The highest nominal net wage in August was recorded in air transport (YuD 24,195), which is higher by 143% than the average net wage paid out at the level of the Republic. In the sector of manufacturing, the highest nominal net wage was registered in the manufacture of tobacco products (YuD 21,426), which was up by 115.5% relative to the average.

The average pension paid out by the Old Age Pension and Disability Fund of the Employed in September 2002 was YuD 6,629¹, which was nominally up by 2.2% relative to the previous month, while in real terms this is an increase by 0.9%. If the mentioned figure is added to YuD 889 of average difference per beneficiary on the basis of adjustment for the period January – June 2002, the average pension paid out in September was YuD 7,528. Calculated thus, pensions paid out in September are nominally up by 16.0% month-on-month, or by 14.5% in real terms.

The ratio of consumer basket per household member to the average pension paid out in September (including the difference), was 0.39, which is significantly lower compared to the previous month. This indicates better purchasing power of pensions.

CHART

Total Income Of Non-Agricultural Households, Consumer Basket Of Food And Beverage, Fuel And Light, and Discretionary Income in Serbia w/o Kosovo and Metohija.

- *Costs Of Fuel And Light*
- *Value Of Consumer Basket Of Food And Beverage*
- *Portion Of Household Income Used For Other Expenses*
- *Total Household Income*

Purchasing Power

The analysis of the purchasing power of the population in Serbia is based on data obtained from the Household Budget Survey, which was conducted by the Federal Bureau of Statistics. Before 2002, the standard of living of non-agricultural households was significantly lower compared to agricultural and mixed households. It is therefore important to assess the purchasing power of this category of the population.

¹ For 2002, the calculation of the average pension per months is recalculated to exclude pensions of beneficiaries from Kosovo and Metohija who do not receive their pensions. This amount comprises the second part of the June pension and the first part of the adjusted July pension.

In the structure of available income for consumption of the average non-agricultural households in 2001, the largest share accounted for the income from regular employment (44.7%) and for pensions (20.5). Furthermore, regular payment of old foreign currency savings in accordance with the law, significantly affected the increase of available means for spending. The share of assets from savings in the total available means for consumption accounted for as much as 18%. The share of income from additional activity accounted for 5.6%, the net assets on the basis of middleman activity and work in private shops for 2.0%, remittances from abroad for 1.8% social benefits for 1.3%, income from property renting for 1% and gifts for 1.1%.

Product	Unit	Amount	August		
			2000	2001	2002
1. Potato					
2. Beans					
3. Onion					
4. Carrot					
5. Beetroot					
6. Spinach					
7. Lattice					
8. Cabbage					
9. Cucumber (fresh)					
10. Peas					
11. Green beans					
12. Tomato (fresh)					
13. Green pepper					
14. Cauliflower					
15. Shelled walnuts					
16. Apples					
17. Pears					
18. Peaches					
19. Grapes					
20. Lemon					
21. Oranges					
22. Prunes					
23. Fresh trout					
24. Hen eggs					
25. Cow milk					
26. White cheese					
27. Honey (natural)					
28. Poultry					
29. Rice					
30. Wheat flour					
31. Bread of wheat flour, type 500					

32. Macaroni of white flour with eggs					
33. Biscuits					
34. Frozen flaky dough					
35. Frozen peas					
36. Tomato paste in tubes					
37. Canned green beans					
38. Canned cucumber					
39. Jams (apricot, rose hip, etc.)					
40. Bottled raspberry juice (concentrate)					
41. Beef, boneless					
42. Pork, with bones					
43. Pork, , boneless					
44. Beef liver					
45. Smoked pork ribs					
46. Smoked pork bacon					
47. Hot dogs					
48. Bologna salami					
49. Delicatessen sausage					
50. Lard, domestic					
51. Cooking oil, refined					
52. Yogurt					
53. Hard yellow cheese					
54. Butter, 250g package					
55. Crystal sugar					
56. Milk chocolate, 100g bars					
57. Candies, 100g package					
58. Coffee					
59. Domestic tea in filter bags					
60. Table salt					

61. Alcohol vinegar					
62. Red pepper					
63. Mustard					
64. Spices					
65. Mineral water, without bottle					
Basket's value					
Average net wage (by new methodology)					

However, the income structure of the poor urban population significantly differs from the average. In 2001, the structure of total available means for consumption was dominated by social benefits (62%), followed by income from additional activity (18.4%), pensions (7.3%), savings from the previous years (6.4%) and loans (4.4%).

High real growth in wages and pensions that was achieved in 2001 relative to 2000 and the payment of outstanding debts towards the citizens on the basis of social benefits and old foreign currency savings, as well as the one-time allowance for the poorest and for pensioners with the lowest income have significantly improved the purchasing power of urban populations. This growth has been continued in 2002, but at considerably slower pace, as was expected, which is in line with the projected concept of macroeconomic policy in this year.

A non-agricultural household in Serbia comprises 3.1 members, on average. The value of the consumer basket is lower for this number of members. Thus, in August 2002, the consumer basket of food and beverages for the average non-agricultural household was valued at YuD 9,034, which was nominally up by as little as 0.9% year-on-year. On the other hand, total income of the average of non-agricultural households in August 2002 was calculated at YuD 24.693, which is nominally up by 46.2%, or 29.4% in real terms compared with August 2001.

A dynamic growth in total income of urban populations throughout 2001 and 2002, coupled with stabilized food prices, permitted all increased costs resulting from the liberalization of electricity and public utility prices to be covered and permitted a permanent increase of the portion of income that can be spent on other needs. The total costs in the group of fuel and light in August 2002 were up by 69.2% year-to-year, or by 303.9% compared with August 2000. Excluding the costs of a consumer basket of food and beverages, and the costs of fuel and light, certain means remain available for spending on other needs. These means in August 2002 were up by 103% year-to-year, or by 2781% compared with August 2000 (see chart).

All this indicates that the purchasing power of the population in Serbia increased considerably in the period 2001 – 2002 compared to the period before changes were began. This is further confirmed by the figures on the amounts of certain products that could be bought for the average net wage in August 2000, 2001 and 2002 (see table above).

Labor Market

The trend of labor restructuring on the labor market continued in September.

The number of employees in private shops (including employers) in March 2002 was up by 5.7%, compared to September 2001 (real employment in private shops is statistically followed at these two points in time). Employment in private shops increased by 11% in March 2002 year-to-year. With regard to the structure of employment in private shops, the number of employers increased by 0.8% and the number of employees by as much as 11% in March 2002 relative to September 2001. According to this, it can be safely assumed that private shopkeepers are increasingly registering employees who used to work as unregistered.

The number of employees in small-sized enterprises in March 2002 was up by 11.6% relative to September 2001. In the structure of total employment in small-sized enterprises, those employed in private small-sized enterprises account for 84.5%, while their number increased by 13.2% relative to September 2001.

The number of employees in the socially-owned sector in Serbia continued to decrease. It was down by 6.9% in August 2002 year-to-year. The registered unemployment rate in August 2002 was 30.1%, which is up by 1.2 percentage points month-on-month, or by 2.9 percentage points year-to-year.

Out of the total number of vacant posts in the period January – August 2002, 81.4% were filled by permanent employment, while in the same period last year, this figure amounted to 71.7%. The number of employees who terminated employment in August 2002 was down by 10.3% month-on-month. Fluctuation (direct transfer from one job to another) in the period January – August 2002 was 36.34%, which is an expected growth rate compared with last year, when the fluctuation accounted for 29.5%.

In terms of unemployment structure, a great number of persons have been waiting for a job for more than three years (43.9% of total unemployment at the end of August 2002). With regard to unemployment structure categorized according to education level, the majority of the unemployed has high school education or lower. This corresponds to the structure of expected demand for labor, with intensification of employment in the coming months being highly likely. As for the age structure of the unemployed, it is dominated by young people up to age 25 (24.4%) and those between 26 and 30 years of age (20.2%). The unemployed between 31 and 40 years of age account for 26.9%, those between 41 and 50 for 17% and over 50 for 11.5%. Women account for 56% in total unemployment.

The results of previous analysis indicate, as far as unemployment is concerned, a relatively unfavorable position of the youth and females. It is therefore necessary that the Government, in completing labor legislation, establishes and creates labor market policy whose main emphasis will be the creation of an environment for new employment. This policy should be compatible with other macroeconomic policies, in particular with fiscal and education policies.

Employment In Small-Sized Enterprises – Total, Private Small-Sized Enterprises And Shopkeepers, The Self-Employed And Employees In Such Firms – March 2000

9% - Small-Sized Enterprises – Total

77% - Socially-Owned Sector

14% - Shopkeepers, Self-Employed And Those Employed In Such Firms

Employment In Small-Sized Enterprises – Total, Private Small-Sized Enterprises And Shopkeepers, Self-Employed And Employees In Such Firms – March 2002

11% - Small-Sized Enterprises – Total

71% - Socially-Owned Sector

18% - Shopkeepers, Self-Employed And Those Employed In Such Firms

Production and Services

According to preliminary data, industrial production in Serbia in August slightly increased (by 0.6%) year-to-year, while in the first eight months of this year, it was up by 0.4% compared to the same period the previous year. It should be kept in mind, however, that a considerable drop in production was registered during the first quarter, while, in the subsequent period, according to indices, in nearly every month production registered growth when compared to the corresponding month in the previous year. Since industry as a rule starts with wider volume of production in autumn, more dynamic growth in industrial production in Serbia is likely as late as in the last quarter; therefore, a forecasted growth rate of 2-3% relative to 2001 seems likely.

Industrial production in Central Serbia evidently started recovery since, after the drop in the first quarter, as of April it has been registering cumulative growth relative to the corresponding months of the previous year. Industrial production in Central Serbia in August was up by 5.1% year-to-year, while in the first eight months of 2002 it registered a growth of 0.6% compared with the same period last year. All three industrial sectors recorded growth, both compared with August and relative to the first eight months of 2001. Energy, gas and water supply increased by 9.5%, manufacturing by 3.7% and mining and quarrying by 3.1% year-to-year.

Slow growth of industrial production in Serbia, therefore, is the result of the drop in production in the first quarter of 2002, as well as of the fact that production in Vojvodina remained at the same level as in the first eight months of 2001 (whereas in August 2002 it was down by 7.7% year-to-year).

With regard to particular industrial sectors in Serbia, w/o Kosovo and Metohija, the highest year-to-year growth in August was registered in electricity, gas and water supply (5.4%); manufacturing stagnated or even dropped by 0.3%. However, manufacturing in the first eight months of this year was up by 0.5% compared to the same period last year.

With regard to the destination of consumption, the manufacture of capital goods in August recorded a dynamic growth by 8.9% compared with August 2001, or by 8.5% in the eight-month period year-to-year. The production of intermediate

goods grew at a slower pace (1.8%, i.e. 1.7%), while the manufacture of consumer goods decreased (by 1.9%, i.e. 2.1%).

In percentage terms, the highest growth compared to August 2001 was registered in the manufacture of coke and refined petroleum products, the manufacture of radio, TV and communications equipment, and the manufacture of basic metals. On the other hand, the most considerable year-to-year drop was displayed in the manufacture of office equipment and components and the manufacture of leather and leather products, and footwear.

An activity which should be the key determinant of GDP growth in Serbia is construction. The value of construction works done in the first seven months of this year increased by 20% compared with the same period last year, or by as much as 66% in real terms in July year-on-year. This results from the increased value of works in all segments of construction, primarily in high-rise construction and civil engineering.

In the first half of this year, transport companies in Serbia registered a smaller number of passengers and passenger-kilometers relative to the same period in the previous year, but at the same time, the volume of transport of goods increased, and the number of ton-kilometers in the period under consideration rose by 8%.

CHART

The Value Of Completed Construction Work – In Real Terms

- In YuD Millions

Activities in the area of tourism were also reduced. The number of tourist nights realized in the period January – August decreased by 4.5% year-to year.

Turnover in the socially-owned catering companies in July is estimated to be up by 6% in real terms, compared to the same month last year, while the total turnover in the period January – July increased by 1% in real terms year-to-year. Modest total growth resulted from the reduced turnover volume in the first four months of 2002.

The highest growth in turnover in the area of services was recorded in trade. Wholesale turnover in the socially-owned sector in July increased by 14% in real terms compared to the same month last year, while retail trade turnover increased by 21%. With regard to the first seven months of 2002, wholesale turnover and retail trade turnover in the socially-owned sector registered year-to-year growth of 10% and 25% respectively. Data on turnover in trade in enterprises with other forms of ownership are not available.

Foreign Trade

According to preliminary data on the exchange between Serbia and other countries, commodity exports in August were valued at US\$ 181 million, while commodity imports were valued at YuD 438 million. Exports in August were nominally up by 37% year-to year, while, with regard to the first eight months of 2002, commodity exports increased by 19%. Commodity imports also registered

a growth by 50% relative to August 2001, i.e. by 24% in the period January – August year-to-year. Due to higher growth rates in imports than in exports during summer (compared to corresponding months of last year), the cumulative growth rate registered in imports was higher than the rate registered in exports, which resulted in the increase of the foreign trade deficit by 9%, i.e. by US\$ 160 million compared to the first eight months of 2001.

Commodity exports throughout this year, except in March, were nominally up compared to the corresponding months of the previous year, while, except for January, February and May, they were up relative to average monthly exports in 2001.

Particularly encouraging are increased exports from Central Serbia, which have registered high growth rates since May compared to the corresponding months of the previous year. This corresponds to the increase in industrial production in this part of Serbia, which also recorded continuous growth since May. Commodity exports from Central Serbia in August nominally rose by 46% year-to-year, while cumulative growth in the first eight months of this year is 16% relative to the same period last year. Given such dynamics of export trends, exports from Central Serbia by the year-end are likely to reach the growth rate of Vojvodina's exports, which were nominally up by 27% in the first eight months of 2002 year-to-year. Exports from Vojvodina have registered considerable growth throughout the year, with growth rates mostly exceeding 20%.

Analysis of the structure of the exchange of goods based on the Standards International Trade Classification points to two sections (i.e. food and live animals and animal and vegetable oils and fats) that recorded a surplus in foreign trade over the first eight months of this year. The section of food and live animals increased its share in total exports from 13 to 21% over the period under consideration. A positive trend in this section results from the surplus achieved in the divisions of cereals and cereal products (year-to-year increase in exports by 3.5 times), fruits and vegetables (a surplus of 60 million nominal US\$), and sugar, preparations and honey (the share in total exports increased from 0.2% to 3.2%). Exports in the section of mineral fuels, lubricants and related materials increased 2.2 times, while imports remained at last year's level. This comes as a result of increased exports of electric power (in the first eight months of 2001, the exports realized in this division were valued at as little as 1/3 million of nominal US\$, while this year, export values reached US\$ 23 million over the period under consideration), and increased exports in the division of petroleum and petroleum products. Exports in the section of manufactured goods classified by materials and in the section of miscellaneous manufactured articles recorded a drop. The former was caused by a drop in exports in the division of non-ferrous metals by 20% and in the division of textile yarn, fabrics, made up articles and related products by 40%. The latter resulted from the decrease in exports in the division of clothing and footwear.

CHART

Indices Of Foreign Trade In Serbia (average 2001 = 100)

Monetary and Fiscal Policy

Interest rates in Serbia in August increased slightly relative to July; active interest rates of banks increased from 1.68% to 1.69% and passive interest rates increased from 0.25% to 0.29% at a monthly level. This probably resulted from the growth of prices in July, when interest rates were negative in real terms, and bankers wanted to compensate partially that loss by increasing interest rates. With a growth of 0.6% relative to July, active interest rates in August were lower by 49.1% year-to-year.

Gross collection of public revenue continued to grow in August. Public revenue collection in August increased nominally by 46.1%, i.e. by 25.5% in real terms year-to-year. Such a high public revenue collection rate cleared the way for the announced set of tax relieves.

The revenue of social insurance organizations displayed higher growth rates both over the period January – August (by 54.2% in real terms) and in August (by 47.4%). This increased the share of this revenue in total public revenue from 35.3% to 37.7% in the period January – August 2002 year-on-year.

CHART

Interest Rates In Serbia, Monthly Level, January 2000 – August 2002

- Monetary Reform
- 1 – NBY Discount Rate
- 2 – Weighted Passive Interest Rate For FRY
- 3 – Weighted Active Interest Rate For FRY
- Interest Margin Of Commercial Banks

TABLE 1

1. Public Revenues In Yud Million
 2. Total
 3. Revenues Of The Budget And Other Users
 4. Sales Tax
 5. Income Tax
 6. Property Tax
 7. Other Taxes
 8. Fees
 9. Customs
 10. Other Revenues Of The Budget And Other Users
 11. Special Revenues Of Federal Budget And Budgets Of The Republics
 12. Revenues Of Social Insurance Organizations
-
- Index
 - In Real Terms
 - Index

TABLE 2

1. Public Revenues Structure (in %)
2. Revenues Of The Budget And Other Users

3. Sales Tax
4. Income Tax
5. Property Tax
6. Other Taxes
7. Fees
8. Customs
9. Other Revenues Of The Budget And Other Users
10. Special Revenues Of Federal Budget And Budgets Of The Republics
11. Revenues Of Social Insurance Organizations

WHAT IS GOING ON WITH THE SERBIAN ELECTORATE?

1. Many counties have difficulties in defining exactly who has the right to vote. This problem primarily concerns incomplete and inaccurate electoral registers, and sometimes even the lack of serious records. Both apply to our country. There are no serious records, and what exists is inaccurate and incomplete. The 2002 census has not been completed, whereas the environment and conditions under which it was carried out, as a non-prioritized state action, does not guarantee maximum quality. The 1991 census is prehistory for us. So much happened in the meantime, with migrations being specially important in that respect. This is not the only problem. Seemingly unproblematic statistics of vital data are challenged by the fact that a number of refugees who had settled in Yugoslavia with the refugee status are deceased, whereas the majority of newborns in the same population are registered as newborn citizens of Serbia. Finally, we have the problem of identity of the state. For example, in one poll conducted on the representative sample, only 3% of citizens were able to say exactly what are the national holidays of Serbia and Yugoslavia. This crisis is reflected in the citizens' attitude of not respecting everything that is required from them by the state. On the other hand, each state, especially the one which runs population registers, requires citizens to report each change in citizenship status or change of residence.
2. The present situation with electoral registers in Serbia is caused by various factors: lack of habit in following necessary administrative procedures when changing residence and complete lack of habit in reporting immigration to other countries, as well as complications associated with the procedure of erasing the deceased from registers. That is why the electorate in Serbia (excluding Kosovo and Metohija) does not comprise 6.45 million voters, and this figure should be reduced by the number of persons appearing in registers, but not appearing in their place of registration. Hence, many of those who live abroad are registered in electoral registers, but do not act as real voters. There is a significant number of persons who are in the country, but reside at an address far removed from the actual voting place. Finally, electoral registers include persons who passed away years ago. Without hard evidence, but according to everything advanced so far and according to statistics about Serbian emigrants in Western countries, I estimate the electorate in Serbia to be less than six million.
3. Moreover, under positive legislation, Serbia also includes Kosovo and Metohija. This means 1.3 million voters more, given the statistics made in Pristina for the needs of the Kosovo elections. This is not a realistic figure and everyone is aware that the electorate in Kosovo cannot exceed 50 thousands. In the absence of a good solution, the Republican Electoral

Committee opted for the least damaging solution by including the number of registered voters in the total electorate which is necessary in order that those really present and willing to cast their vote are included. Thus, we have the smallest electorate ever, which at the same time largely exceeds the actual electorate. Namely, when the poll offers information that 63% of respondents will cast their vote on election day, this is as little as 3.7 million, since it refers to actual Serbia without Kosovo. With regard to electoral registers, this is less than 59%, or to put it another way, in order to reach 50% of the electoral registers, at least 54% of those actually present must vote.

4. In the latest presidential election in Serbia three strong political blocks emerged - SRS, DOS and DSS. Seselj registered over 800,000 votes. With the votes scored by other more or less oppositional candidates, we are coming to over one million of those who support Seselj. The candidates who come from the original DOS together registered 2.15 million votes. Can the outcomes of this presidential election be interpreted as an announcement of a new political map of Serbia, or does this concern routes which had been set a long time ago? The answer seems to be somewhere in the middle. SPS is evidently losing its strength, while the Radicals are taking over a leading role. SRS and its leader used to have the support of 1.7 million voters, but also of only a couple of thousands voters in the past. The latest result indicates a recovery of this party and its taking over of a leading position within the opposition, but not also a return to their best ratings. The votes that went to candidates who ranked poorly at the presidential election probably hide additional, although not too considerable potential for this party.
5. The democratic course has not strengthened. It is rather stagnating. Namely, communication between presidential candidate Miroljub Labus and his followers was clear and primarily concerned two issues – the continuation of a general progressive trend in Serbian, and acceleration of reforms. This is diametrically opposed to the position held by the Radicals, although it has not been made entirely clear what relationship between DOS, G17 PLUS and DS voters can expect.
6. The position held by presidential candidate Vojislav Kostunica and his DSS is the most popular, but least well defined. Clearly perceived by its followers as national and as democratic, this option might attract both opponents and supporters of reforms, both those satisfied and dissatisfied with the course of changes in Serbia.
7. Regarding everything set down here, it seems that no considerable changes in the electorate within the basic determinants of policy in Serbia have been made, compared with the situation in the late 2000. At the same time, it seems that no significant decomposition within the basic dichotomy demonstrated in September 2000 occurred. There are two basic characteristics – the Radicals have taken over leadership of the supporters of total changes, while within the original DOS a regrouping is underway, which is not likely to end until the new parliamentary election.

8. Generally speaking, one quarter of Serbia does not participate in the elections and does not vote – hence, about 4.5 million citizens make decisions about the future of the country. Sometimes all of them go to the polls, but it can also happen that only 3 million voters turn out. There used to be more of those who voted, but with rather questionable results where Kosovo is concerned. 3 – 4.5 million voters understand the significance of the elections and have a high degree of devotion to the offered options. Of the $\frac{3}{4}$ of the population that constitute the balance of power in the country, one portion has a firm democratic orientation and the other portion are staunch nationalists. Even during the worst of times, Serbia did not have less than a million cosmopolitan democrats, but the number of staunch, authoritative nationalists is approximate. These two groups know well what they want and have a clearly established basic system of values and consistent political positions. The majority of remaining voters, i.e. over two million citizens, either follow the leader or follow inertia, being governed by limited information and understanding. Certainly, there are many who simply cannot or do not want to waste too much energy on decoding political messages that are not expressed directly or formulated precisely.
9. During the Milosevic regime, the disunited opposition block did not stand a chance for a long time, since many disinterested voters simply followed the former parliamentary majority. With continuous failures of the regime, this majority kept melting. It took at least four years for politics to create what the majority wanted - an opposition united around an anti-Milosevic agenda. Seemingly enormous re-composition of the electorate did not take place immediately, despite Milosevic's defeat, primarily because electoral orientation in 2000 was largely motivated by negative, rather than positive tension. A NO to Milosevic did not yet put an end to everything he used to represent, nor was it an unconditional YES to his opponents. A broad coalition won easily, but it has not been able to offer common positions on the direction of future progress; this process is clearly heralded by the presidential elections, but is not finished yet.
10. Finally, something is visible: Serbia is moving toward the defragmentation of parties and will probably wind up with at least three strong blocks, with a potential for another two in the future. Most clearly distinguished are SRS, DS and DSS; regardless of arrangements made with others, these are basic political options that have mass support. Apart from the fact that with such a balance of power, the Government can be changed without the dissolving of Parliament, there are relations which indicate considerable problems for any combination of "two against one". That is why it would not be a surprise, or even would not be bad, if some other stronger options appeared, besides the existing ones - either through separation of the social democratic group of parties from DOS, for example, or the appearance of a purely technocratic group that would somehow diminish the influence of both DS and DSS, or the distancing of the socialists from the radicals toward a clearer leftist orientation.

11. It seems to me that the game of figures indicates that Serbia has finished one political epoch, but has not yet entered another.

CHART

In what direction is Serbia going?

- do not know, have no opinion
- wrong direction
- right direction

PIE

How to continue?

- partial change of direction
- continue in the same way
- complete change of direction

Macroeconomic Topic I

BENEFITS OF ONE YEAR OF SUCCESSFUL IMPLEMENTATION OF REFORMS

In October 2001, when the work of the Serbian Parliament was blocked, resulting in the impossibility of passing laws critical for further implementation of reforms in Serbia, the author of this article made an additional assessment of costs of abandoning reforms in three different scenarios, basing it on a previous assessment of the cost of the Milosevic regime. One year later, the situation in Parliament has not changed, although a lot has been done in terms of reforms in Serbia. Therefore, the issue of a choice between swift reforms, slow reforms and a shift toward demagoguery and subsequent isolationism has become topical once again.

Former assessments had as their starting point the cost of abandoning reforms in year 2002. The price of the Milosevic regime concerns a definite value and was estimated at the remaining realization of US\$ 514.3 billion. The additional costs of abandoning reforms, in view of different scenarios, were the following: according to the Aid-dependant scenario – US\$ 489 billion, the Romanian scenario – US\$ 567 billion and the Populist – radical scenario – US\$ 653 billion.

CHART

Potential GDP and Alternative Scenarios of GDP Growth

1. *potential GDP*
2. *according to "Aid-dependant" scenario*
3. *according to "Populist – radical scenario"*
4. *according to reform growth rate*
5. *according to "Romanian scenario"*

Without wanting to list what was done in the area of economic reforms in the past one-year period, the GDP in 2002 will, measured in current US\$, correspond to the GDP assessed under "the reform scenario" – i.e. US\$ 14 billion (real GDP growth + YuD exchange rate appreciation / US\$ depreciation).

Hence, if the year 2002 is taken as a basis for the assessment of alternative costs of abandoning reforms, these costs would reach US\$ 464, 540 and 625 billion for each scenario respectively.

CHART

Separation of Losses Cumulated By the Former Regime From the Costs of Indecisiveness In the Implementation of Reforms, in US\$ Billions, 2001 Estimation

- *losses cumulated by the former regime – outstripped by reform growth rate*
- *new loss by Aid-dependant scenario*
- *new loss by Romanian scenario*
- *new loss by Populist – radical scenario*

The survival of the reform course over one year meant a benefit in terms of smaller additional loss in each considered scenarios of US\$ 25.3, 27.1 and 27.7 billion, respectively.

To illustrate this, we are presenting the chart of assessed new GDP loss according to the Populist-radical scenario. Due to assessed stagnation of GDP based on this scenario, the benefit from reforms is equal in each year of projection, amounting to US\$ 1.46 billion. This is the value of GDP growth in 2002 and indicates that stagnation (at best) would separate at higher level.

CHART

Separation of Losses Cumulated By the Former Regime From the Costs of Indecisiveness In the Implementation of Reforms, in US\$ Billions, 2002 Estimation

- *loss cumulated by the former regime – outstripped by reform growth rate*
- *new loss according to Aid-dependant scenario*
- *new loss according to Romanian scenario*
- *new loss according to Populist – radical scenario*

This chart clearly indicates that relative loss from the realization of this scenario, given different assessments (2001 and 2002) is highest in the first years, while later, benefits from the first year of reforms (GDP growth of US\$ 1.46 billion) become relatively irrelevant compared to the costs of eventual realization of that scenario.

These assessments are aimed at trying to call for both politicians and citizens to realize that **time** is the most important resource for the course of reforms.

CHART

The Benefit Of Non-Realization Of The Populist – Radical Scenario Of Economic Policy, In US\$ Billions

1. *new loss according to Populist – radical scenario, 2002 assessment*
2. *new loss according to Populist – radical scenario, 2001 assessment*
3. *unrealized loss - benefit from reform*

If time is the most important resource, it is then necessary (1) for a run-off presidential election to be successful, and (2) to continue and accelerate the reformist processes.

The values used in the assessments are hardly comprehensible even to economists, not to mention politicians, whose economic expertise rarely goes beyond the necessity to fill their party's (and personal) financial funds. We will

therefore try to be more precise and to point out to the basic consequences of activation of any of the mentioned scenarios:

- Impossibility of regular payment of pensions, other social transfers, wages in the public sector, etc.
- Consequent economic instability would affect increase in the inflation rate through the change of YuD exchange rate; wages would decrease from EUR 163 from August to the level of EUR 40 – 50, which would prompt social unrests.

We hope that the run-off of presidential election in Serbia will succeed and that the initiated process of reforms will continue.

Macroeconomic Theme II

CHANGES IN TAX POLICY PROJECTED FOR 2003

Introduction

The defined directions of development and improvement of the tax system as a whole prompted the Ministry of Finance and Economics of the Republic of Serbia to propose a new set of tax measures so as to pursue overall tax reform initiated in April. Practical enforcement of tax legislation leaves room for reconsideration, correction, supplements or better organization of some of the existing solutions; practical experience drew attention to certain gaps in the existing regulations; changed economic or social environments create the need for introducing some new tax measures, i.e. for organizing the existing measures in a different way. The following are among key reasons that prompted the proposed changes in tax policy:

1. the need to put the instruments of the tax system in the service of economic and social policy;
2. reduction of the gray economy;
3. incentives for the privatization process;
4. development of the securities market.

Corporate Income Tax

Within the proposed tax measures, the Ministry of Finance and Economics of the Republic of Serbia put major emphasis on the introduction of various new tax incentives, which are aimed at stimulating direct investments and new employment.

This concerns the following measures:

- Reduction of corporate income tax rate from the present 20% to 14%; thus it will become the lowest in the region (e.g. Slovenia – 25%, the Czech Republic – 25%, Croatia – 20%, Hungary – 18%, Macedonia – 15%, etc.). This will definitely be the best tax incentive for taxpayers and at the same time will increase competitiveness.
- Changes in investment credits for investing in fixed assets comprise the following:
 - a.) Tax credit for investing in fixed assets is increased from 10% to 20% of the invested amount (i.e. from 30% to 40% for small-sized enterprises).
 - b.) Furthermore, it is proposed that limitations with regard to maximum amount of tax credit (so far, a tax credit could not exceed 50%, i.e. 70% for small-sized companies) of assessed tax liability for the year in which the investment is made, also be removed.
 - c.) Time limit on the transfer of the unused portion of a tax credit is proposed to extend from the present 5 to 10 years.

If proposed tax measures were adopted, the text of the Corporate Income Law should be revised with respect to one technical detail, i.e. the phrase “up to the limit from paragraph 2 of this article” in article 48 should be erased (if that limit is removed as proposed).

- Tax credit for new employment is due to increase from the present 40% to 100% of gross wages, i.e. wages paid out to these employees increased by related contributions which rest with the employer. Another novelty is that reduction in the number of employees, which brings about the loss of the right to this tax relief, is considered only as a termination of employment on the basis of discharge initiated by the employer, and not as termination by the employee, which was the case thus far (as the company can not influence such termination). This measure which allows the employer to reduce income tax for each newly-employed worker in the full amount (i.e. 100%) of gross wages over two years from the beginning of employment, aims at providing incentive for new employment, as well as at stimulating registration of workers employed in the gray economy.
- A completely new measure concerning “large-scale” investments allows company income tax deductions over a ten-year period, starting from the first year in which taxable income is generated, under the following conditions:
 - a.) if investment in fixed assets (specifically, in new technology and equipment, not in equipment which is already in use in Serbia) exceeds YuD 600 million (either for investment made by the taxpayer, or for investment in the taxpayer’s fixed assets made by a third party), and
 - b.) if the company initiates full-time employment for at least 100 persons during the investment period.
 - Tax break for investments made in the areas of special interest for the Republic of Serbia, aimed at stimulating the break for the period of five years, starting from the first year in which the company generated taxable income, is allowed under the following conditions:
 - a.) The investment in fixed assets must exceed YuD 6 million (whereby the total amount must be invested in new fixed assets, not in equipment already in use in the Republic of Serbia).
 - b.) The enterprise must exploit 80% of the value of the fixed assets in performing the registered activity in the area of special interest for the Republic of Serbia.
 - c.) The taxpayer must employ at least five persons with permanent full-time employment during the period of investment.
 - d.) At least 80% of the permanently employed must be residents on the territory of the municipality of special interest for the Republic.

- The cutoff period for transferring operating and capital losses forward and accounting them against gain from future fiscal periods is extended from five to ten years.
- The income realized by an enterprise through the sale of bonds issued in accordance with rules which regulate fulfillment of obligations by the Republic, on the basis of credits for economic development and foreign currency savings of citizens, is not considered capital gain and is not subject to taxation. This measure will provide a stimulating environment for the development of the securities market and will motivate the purchase of bonds issued on the basis of citizens' foreign currency savings and bonds issued in order to fulfill obligations by the Republic of Serbia on the basis of the credit for economic development.

Personal Income Tax

Governed by the need to attain certain non-fiscal goals of taxation through tax policy measures (e.g. development of agriculture and entrepreneurship, incentives for investments, stimulation of employment, stimulation of privatization, development and affirmation of sport, etc.), the Ministry of Finance and Economics of the Republic of Serbia decided to propose the following measures concerning personal income tax:

- Personal income tax exemptions are extended to:
 - a.) retirement compensations – up to the amount of two average monthly wages paid out at the level of the Republic per employee, according to the latest figures released by the competent republican office in charge of statistics;
 - b.) compensation paid out by the employer to the employee whose work is no longer required – up to the amount set by the law which regulates labor relations;
 - c.) one-time financial compensation paid out to persons whose employment terminates in the process of restructuring of a company or due to preparations for privatization, liquidation and bankruptcy – up to the amount defined in the Social Program for employees whose employment terminates in the process of restructuring of an enterprise or due to preparations for privatization, liquidation and bankruptcy, whereby for persons over 50 the value of compensation is not limited.
- Tax exemption on wages of citizens and residents of the Republic of Serbia who are employed as experts or administrative staff at foreign organizations is canceled.
- Reduction of the tax rate on income from agriculture and forestry from the present 20% to 14% (aimed at stimulating the development of agriculture, approximating the income tax rate on income of self-employed persons).
- Reduction of the income tax rate on the income of self-employed persons from the present 20% to 14% (aimed at development of entrepreneurship and adjustment to corporate income tax rate).

- Entrepreneurs will also be granted new tax incentives for investments.
- Income from dividends is reduced, prior to establishing the tax base, by the amount of annual installments paid by the physical person – i.e. buyer of securities at public auction – before the payment of a dividend, at most up to the amount of the paid dividend. This measure is mainly aimed at stimulating privatization of socially-owned and state-owned enterprises, and, above all, at stimulating the participation of physical persons in that process.
- Instead of the former practice of establishing flat income of entrepreneurs on the basis of the average monthly income in December in the Republic of Serbia, it shall now be established on the basis of average monthly income earned in the year preceding the year for which the tax is being assessed, or over a specific period during the previous year.
- Taxable income of sportsmen/women and sports experts is regulated in a different and a more precise way. The Law will establish precisely what is considered to be the income of sportsmen/women and sports experts, and which is not defined as salary, but is referred to as “other income”. This comprises: compensation on the basis of concluded contract (transfers, etc.); compensation for the exploitation of the image of a sportsmen/women; financial compensations for top-rate sportsmen/women for special merits; scholarships and food allowance received by amateur sportsmen/women from sport organizations which exceeds the established untaxed amount; scholarships to top-rate sportsmen/ women for advancing their skills and performance; financial and other awards; income on the basis of national awards and awards for special contribution to the development and affirmation of sports (coaches, referees, delegates, etc.). Tax rate on such forms of income generated by sportsmen/women and sport experts accounts for 20%, whereby it allows for higher normative costs in the amount of 50% (normative costs regarding other “other income” accounts for 20%); thus, the effective tax rate is actually 10%. This measure is expected to reduce tax evasions which are very common in practice, especially with regard to the registration of income of sportsmen/women. Aimed at reducing the gray economy, also proposed is the establishment of a tax after deductions for those who pay sportsmen/women and sport experts their income. Furthermore, the reduction of the tax burden for sport activities will contribute to the attaining of another extra-fiscal objective of taxation, i.e. the development and affirmation of sports. Of course, the income of sportsmen/women and sports experts is included in taxable income in terms of annual personal income tax.

- Income achieved on the basis of part-time and casual work is treated, in terms of the tax system, as “other income” (no longer as salaries), since it concerns income which is generated, according to the Labor Law, on the basis of additional working engagement, and not on the basis of employment. The tax rate for such incomes will be 20%, with the deduction of normative costs of 20% from gross income.
- Tax credit of 40% on the income earned by a member of a pupils’, youth or students’ cooperatives is to be revoked in order to stimulate employment and to approximate taxation treatment of such income to the income earned without mediation of mentioned cooperatives. This would also reduce the gray economy which used to be very common in practice in the abuse of employment through students’ or youth cooperatives.
- Untaxed portion of annual personal income tax is increased (i.e. it is equalized with the untaxed amount granted to foreign residents, employees of a resident persons or a permanent business unit of non-resident persons). This also applies to residents who are sent abroad in order to perform certain activities for a resident legal entity (as residence in a foreign country involves additional expenses of accommodation, schooling of children, etc).
- Instead of former progressive tax rates in the range of 10%, 15% and 20%, a single proportional rate of 10% shall be introduced with regard to annual personal income tax. This change will apply to income achieved in 2002. In the Czech republic, for example, tax rates amount to as much as 40%, in Croatia to 35%, in Romania to 40%, in Bulgaria to 38%, etc.

Property Tax

At this stage of tax reform in Serbia, certain changes have been proposed, in particular with regard to property tax, in terms of its dynamics (inheritance and gift tax, tax on transfer of absolute rights). The main objective of the proposed measures is to stimulate the privatization process with tax policy instruments, as well as to motivate the securities market. Also, they would provide balanced tax treatment between shares (i.e. stakes) acquired in the privatization process and shares (i.e. stakes) acquired in the process of ownership transformation. This concerns the following measures of fiscal policy:

- The range of tax exemptions regarding gifts and inheritance shall be extended to include: a.) transfer of free shares allotted through the privatization process; b.) transfer of bonds issued for sake of fulfillment of obligation by the Republic of Serbia on the basis of hard currency savings of citizens, and c.) transfer of bonds issued for the sake of fulfillment of obligations by the Republic of Serbia on the basis of credits for economic development for Serbia.

- The transfer of shares in the privatization process, from the entity undergoing privatization to the share acquirer; transfer of bonds issued for the sake of fulfillment of obligations by the Republic of Serbia on the basis of hard currency savings of citizens, as well as transfer of bonds issued for the sake of fulfillment of obligations by the Republic of Serbia on the basis of credits for economic development of Serbia shall be exempt from taxation of the transfer of absolute rights.
- Registered securities and shares in limited liability enterprises which were allotted to or acquired by a taxpayer in the process of ownership transformation, i.e. privatization, shall be exempt from property tax on ownership rights (tax on basic portion of property) for the period of five years as of the day of acquisition of ownership rights to such securities, i.e. shares.

Tax On Turnover Of Goods And Services (Sales Tax)

The set of proposed measures of tax policy includes certain changes in the area of taxation of turnover of goods and services. The amendments to the existing Sales Tax Law are intended to use sales tax for pursuance of economic and social policy in Serbia in the future.

In that respect, the following measures are considered especially important:

- Sales tax exemption is foreseen for the following:
 - cooking oil, cooking lard and sugar (social role of tax);
 - products received as humanitarian aid in the country by Red Cross and other local humanitarian organizations, i.e. Commission for Refugees.
 - PC computes and software (aimed at creating conditions for more efficient exploitation of computer technology);
 - Jet propulsion fuel used for the jet propulsion of aircraft that fly on international lines (regular and charter), providing that the delivery of the fuel is carried out at a special place – bunker and that the exporting customs clearance of fuel is performed and a customs declaration is issued (aimed at increasing the competitiveness of local air companies on international flights).
 - Products obtained on the basis of contracts on donation concluded by the FRY or a member republic with international financial organizations, as well as on the basis of contracts with international financial organizations concluded by third parties, in which the FRY or a member republic appears as a guarantor, whereby the contract does not provide for the payment of tax with the obtained assets.
 - Tax exemption for the turnover of services is extended to the service of renting business and other premises as performed by a natural person – a citizen who does not perform this as a registered activity.

Furthermore, the following is of special significance within the proposed measures:

- Establishment of legal groundwork for the introduction of “fiscal cash registers” in Serbia. In that respect, retailers, i.e. persons who provide services to natural persons are obliged to record each individual transaction in a cash register with fiscal memory (“fiscal cash register”). This obligation will not apply only to the selling in kiosks, to trade in petroleum products at filling stations and on trade in agricultural products, self-manufactured products and handcrafts at green market counters and in similar facilities. The Law stipulates precisely that the Government of Serbia makes regulations on the ways of recording turnover in fiscal cash registers and on the dynamics of their introduction, providing that the establishment of fiscal cash registers is completed by December 31, 2003, at the latest.

This measure will yield manyfolded positive effects: (1) creation of a legal framework for establishing fiscal cash registers is a necessary prerequisite for the introduction of value added tax in the Serbian taxation system; (2) fiscal cash registers are an important measure in the battle against the gray economy; and (3) better financial discipline not only with regard to taxpayers, but also to citizens. Namely, it is proposed that a fine in the amount of YuD 1,000.00 be levied for the offence made by a natural person, i.e. the buyer of a product or user of a service who does not possess a receipt, i.e. segment of cash register ribbon, for the purchased products or used service right after having left a shop or other business premises.

Excise Tax

Proposed amendments to the Law on Excise resulted from the need to use this tax instrument not only for fiscal, but also for certain economic purposes.

Two measures have been proposed in that respect:

- Reduction of excise tax on motor oils and grease from the current adjusted (indexed) amount of 68.14 YuD/l to 45.00 YuD/l. This measure is expected to contribute to the decrease of the presently high share of excise tax in the price structure of domestic motor oils and grease (which account for as much as the producer's price). The decrease of the amount in dinars of excise tax by 34% shall provide better competitiveness of domestic producers of motor oils and grease, as well as a reduction of the gray economy in this area.
- Excise tax exemption for jet fuel that is used for the jet propulsion of aircraft that fly on international lines (regular and charter). However the right to this exemption requires that the

following conditions are fulfilled: (a) the delivery of fuel to a special place – bunker, (b) the exporting customs clearance of fuel is performed, and (c) a customs declaration is issued. The proposed tax exemption will result in the decrease of operating costs of domestic air companies that fly internationally, and should secure their better competitive position with regard to foreign companies. Up to now, all foreign companies, under their national tax regulations, have been exempt from excise tax on jet propulsion fuel, which resulted in lower prices and their better competitive position compared to domestic companies regarding international flights. The Ministry of Finance and Economics of the Republic of Serbia, however, estimates that, owing to the exemption of excise tax on jet propulsion fuel, the influx of revenues to the Republic's budget will be reduced by about YuD 110 million at an annual level.

Taxes On Utilization, Bearing And Possession Of Goods

Considering law enforcement and citizens' initiatives (e.g. owners of trophy weapons, etc.) thus far, the Ministry of Finance and Economics of the Republic of Serbia decided to propose certain corrections with regard to the taxes on utilization, bearing and possession of goods. This proposal has been explained by the fact that practice has shown that some goods, which have been subject to the mentioned tax over the past year and a half, are not the manifestation of any special economic strength of citizens, and they should therefore be excluded from taxation.

In that respect, tax exemption for the utilization, bearing and possession of goods refers to:

- Boats without engine up to a length that does not exceed 15 m (with or without cabin) and boats with engines up to 7.35 kW, and up to a length that does not exceed 15 m (with or without cabin).
- Vacation cottages and house boats.
- Trophy weapons (two registered pieces at most)
- Weapons that the taxpayer received as a prize or on the occasion of retirement from the Yugoslav Army or the Ministry of the Interior (one registered piece of weapon for which the lowest tax is prescribed, at most)
- Weapons used by authorized weapon and ammunition producers as a fixed asset (equipment) in the process of military production.

International conference organized by Alma Quattro, G17 Institute and Olaf & McAteer

CORRIDOR 10 – PATH TO DEVELOPMENT AND INTEGRATION

A two-day international conference “**Corridor 10 – Path to Development and Integration**”, organized by Alma Quattro, G17 Institute and Olaf & McAteer, was held at the Intercontinental Hotel in Belgrade on September 5 – 6, 2002. The conference was divided into three units: Foreign Direct Investments, Infrastructure of Corridor 10 and Incentives for Economic Development and Integration Processes.

Opening the conference in the capacity of chairman, **Milko Stimac**, G 17 Institute CEO, welcomed participants and presented conference agenda, working schedule and the organizers of the conference, and announced the first speakers.

Welcoming Speeches

Miroljub Labus, Deputy Prime Minister in the Federal Government and Minister for International Economic Relations officially opened the conference. Mr. Labus firstly pointed out the importance and complexity of the Corridor 10 project, and expressed his belief that our country will shortly complete all preparatory activities for the beginning of concrete implementation of the project.

Since there is no development without infrastructure, present pro-reformist authorities have decided to accelerate the reconstruction of existing infrastructure. The Federal Government, in cooperation with the European Bank for Reconstruction and Development and the European Investment Bank, has provided financial means for the modernization of 870 km of road network. However, this model of financing – i.e. debtor financing – belongs to the past, Mr. Labus underlined. A new technique of financing the construction of infrastructure will be applied to the Corridor 10 project. It foresees a strategic partnership between the state and the economy, with owner investments dominating over credits in property structure of a company and with sharing of risk among co-owners. A new state-owned company will be set up with 100% state ownership at the beginning (land, existing roads and facilities). With capital increase in this company, the state will be left with 51% ownership, while the owners of the remaining 49% will certainly be allowed to borrow from international financial organizations, with the participation of foreign investment funds, commercial banks, local investors and others being expected.

This project is a great opportunity for the development of the Yugoslav economy as a whole. The direct impact of this project on employment refers to likely job opportunities for 22,000 workers in the construction of Corridor 10. Greece is especially interested in assisting financially in the construction of the Corridor,

Mr. Labus stressed by way of conclusion and announced the conference officially open.

Marija Raseta – Vukosavljevic, Minister of Transportation and Telecommunications in the Government of the Republic of Serbia began with the presentation of technical information associated with Corridor 10. It is the shortest land route between Central Europe and the Middle East, and connects eight countries directly, and another six indirectly. In its total length (2,360 km), 800 km of the Corridor passes across Yugoslavia and Serbia, which accounts for 34%.

Because of this, our country, i.e. the condition of our railway and road infrastructure, is very important for Corridor 10, Mrs. Raseta Vukosavljevic stressed. The existing transport infrastructure in our country is in very poor condition, but the government has paid special attention to this issue, which resulted in investments that are three times higher in road infrastructure in 2001, compared with 2000 – in physical terms, this amounts to about 306 km of new and reconstructed or rehabilitated existing road networks. In this and next year, owing to loans from the European Investment Bank and the European Bank for Reconstruction and Development, the rehabilitation of another 131 km of road networks is projected, from which 28 km are part of Corridor 10, along with 100 km of the remaining infrastructure, since it is also necessary to connect local infrastructure with the Corridor. The EIB and EBRD have also allocated assets for the restructuring of another 864 km of road infrastructure by 2005, out of which 500km are on Corridor 10.

As far as railway infrastructure is concerned, 32% of the total railway infrastructure of Corridor 10 passes across our country. The current condition of the railways is similar to that described in the road networks. Out of the total of 3,800 km of railway networks, only 27% account for electrified railways. Public enterprise ZTP Belgrade is heavily indebt and operates at a loss. Last year, the Government prepared the draft of a new law on the railways and decided to start up a new enterprise for the railways - "The Railways of Serbia". Loans from the EIB and EBRD have been provided for the purchase of new engines, for modernization of mechanization, maintenance of tracks and for a social program. It was confirmed that the total length of railway that is to be reconstructed is approximately 100km.

In conclusion, Minister Raseta – Vukosavljevic stressed that without foreign financial assistance, Corridor 10 could not be capable of supplying good service, and it depends on Europe how much all of us will be able to use the services of this Corridor.

In his introductory statement, **Mladjan Dinkic**, Governor of the National Bank of Yugoslavia, stressed that our country has completed the stage of macroeconomic stabilization and the achieved macroeconomic conditions will remain stable in the long term. A move from the stabilization stage to the development stage is not possible without the development of infrastructure (traffic infrastructure and telecommunications).

Governor Dinkic emphasized as very important that the Government of Serbia has chosen partnership between private and public sectors as a funding pattern

for this project. The advantages of such a partnership is that the responsibility for the construction and maintenance of roads does not rest only with the state, and therefore tax revenues can be spent for other purposes. The National Bank has mediated between the Serbian government and the biggest investment banks; what is left now is to select the best offer for the financial adviser on the tender. The role of banks is very important for the entire project, governor Dinkic pointed out, but not before the second stage, when partnership between the private and public sectors will be established, since many companies will be asking commercial loans from banks. In his opinion, in the initial stage, eminent foreign insurance companies will have an important role since they should facilitate entry of foreign companies to this market.

Jakob Presecnik, Minister of Transportation in the Slovenian Government stressed that good and intensive cooperation between Slovenia and Yugoslavia resulted in the signing of an agreement on highway traffic, while the negotiations on air and mixed traffic are underway.

Pointing out that expert collaboration on an international level is of key importance for further development, Minister Presecnik stressed that Slovenia is ready to present its rich and positive experience in the area of transportation and construction of transportation infrastructure (in the country, and from the process of getting closer to the European Union, and from cooperation with international financial organizations) to its counterparts in Serbia. The Minister also assumes that any effort invested in the construction and modernization of infrastructure within Corridor 10 would be futile unless all countries have conditions for normal traffic, in terms of infrastructure and means of transportation, but primarily in terms of removing administrative barriers at border crossings.

In conclusion, Minister Presecnik stressed that collaboration on the Corridor 10 project is an opportunity and an obligation, both requirements and possibilities are great, but that the final outcome depends on us and on our work. He hopes that at the next conference on Corridor 10, all reports will reveal progress made in this area.

Hristos Verelis, Minister of Traffic of the Greek Government addressed the participants via a video link.

Foreign Direct Investments

The first unit of the working part of the conference addressed foreign direct investments. During two days of work, the conference was chaired by **Zaneta Ostojic – Barjaktarevic**, from the G 17 PLUS Project Council and **Aleksandra Jovanovic**, Head of Institutional Reform Department of the G 17 Institute.

Henry Russell, General Manager of the Yugoslav branch of the European Bank for Reconstruction and Development (EBRD) presented the actions taken by this institution in Serbia, as well as the strategic choice of partnership between public and private sectors, and budget funding of the transportation infrastructure.

Together with the European Investment Bank (EIB), the EBRD has already provided funds for the rehabilitation of 490 km of roads on Corridor 10 in Serbia, and these assets are already available (EUR 76 million by EBRD and EUR 90

million by EIB). This is a traditional way of funding, i.e. loans guaranteed by the state.

Initial experiences the EBRD had with partnerships (construction of the M1 – M15 highway in Hungary) was not as smooth as projected due to an overestimated level of traffic, so that investors lost plenty of money. The upside of such a solution is that the state transfers a part of the risk onto the private sector and thus save citizens' money. In Mr. Russell's opinion, a very important element for this kind of partnership is good planning and analysis.

Mr. Russell also pointed out characteristics of project financing and partnership, as well as the pros and cons of both approaches. Although different, these two approaches have several common characteristics: political risk exists in both cases (due to failure, negligence, skyrocketing costs, etc.), society bears the expenses in both case (either through taxes or through tolls), and state presence is evident in both cases.

In the case of Serbia, the EBRD has relied mainly on traditional ways of funding so far, due to numerous problems which were not favorable for private investments. It is necessary, however, to encourage investors to invest in such projects when it is sensible, but only by providing prudent and detailed analysis of terms (whether there is going to be any traffic at all?). In Mr. Russell's opinion, Corridor 10 is an important road on which there is going to be enough traffic and it is therefore the right place for private investors. The EBRD's approach is to make an objective assessment of both funding patterns through comparison of whole life costing).

In conclusion, Mr. Russell gave certain EBRD recommendations for Serbia, stressing that initial funds are provided by EBRD and EIB, but it is necessary to begin immediately creating plans and analyses for future concessions. It is necessary to have a dialogue with potential investors, to set up a state company for this project that will be privatized later, as well as to consider some additional and commercial sources of financing.

Dusan Vujovic, adviser in the World Bank, named the entire initiative of infrastructural projects in Serbia as project "IIDS", i.e. "Initiative for infrastructural development in Serbia". Specifically, this concerns strategic partnership of public and private sectors based on the new concept of financing, which is aimed at satisfying infrastructural needs of Serbia and of the Balkans, and of the entire region, not only in the short, but also in the long run.

Mr. Vujovic sees this project as necessary since traditional project funding is associated with serious constraints, not only as an outdated funding pattern, but also since it is hard to get new loans (inherited high level of indebtedness, limited resources of international financial organizations, high level of risk).

Strategic partnership between the private and public sectors has the characteristics of other types of partnerships: the state invests resources with other partners, supports projects which cannot be carried out by the state alone, shares both outcomes and risks of investment. The IIDS differs from other forms of partnership in that it starts from the macro level, i.e. it focuses strategic projects with widest developmental impact and tends to attract private sector

investment through the provision of a legal and institutional framework and the control of key non-commercial risks.

In Mr. Vujovic's opinion, Corridor 10 is one of a number of such key strategic projects. Corridor 10 is a project of strategic importance for Serbia, the Balkans and the region of Southeastern Europe as a whole, and has a huge potential developmental impact. This concerns the fact that Corridor 10 is supposed to revive large investments made in the past (infrastructure which is already in place); it is the first direct connection in terms of complete infrastructure (highway, accompanying services, etc. including trade and transport administration and administration of all kinds of permits) from Western Europe to Greece and Turkey and beyond. It should have a significant primary and secondary economic impact on growth, employment and income.

There are many potential partners for this project. As for international public organizations, there are multilateral (World Bank with its agencies, EIB and EBRD) and bilateral institutions (export-import banks of developed countries, agencies that provide guarantees and developmental agencies); furthermore, there are private financial institutions, such as local and foreign commercial banks, foreign investment banks and investment funds, local and foreign insurance companies, and finally., local and foreign private sectors: construction companies, companies for the production of construction equipment, companies in the area of energy supply, tourism and catering, transport and telecommunications companies, trade companies, etc.

With regard to who could be the advisor and leader for this project, Mr. Vujovic stressed that there are many available solutions which are associated with particular advantages and shortcomings. This role could be taken over by international financial organizations, as they are reliable and reputable, but, at the same time, offer so much red tape that often slows down progress. A consortium of commercial and / or investment banks is a very good solution, but requires some time to be organized. Finally an investment or commercial bank with substantial capacity and reputation can be selected to act as an adviser – adviser to the state and guarantor of quality of the project in question. It is important that such a bank is selected according to the rules of competitive and transparent choice and that it is engaged under favorable terms.

In conclusion, Mr. Vujovic addressed what in his opinion is a very important issue – the management of this project and its assets. He recommends external management of the project which is independent from investors; investors, i.e. shareholders should express their positions through legal management bodies (management board, council or committee) and provide full transparency of management structures and working rules, with full financial and managing accountability as a critical factor for the success of this partnership.

The Infrastructure of Corridor 10

The second conference unit referred to the infrastructure of Corridor 10.

This unit was opened by **Dragoslav Sumarac**, Minister for Urbanism and Construction in the Government of the Republic of Serbia. Mr. Sumarac

presented in detail what has been done so far and what needs to be done with regard to road and railway networks, gas lines, optical cables, land planing and accompanying services along Corridor 10.

The creation of land plans is underway, and for Corridor 10 they should be completed by the beginning of next year, respecting legal procedure.

Minister Sumarac then presented concrete data on the existing and on necessary road infrastructure and accompanying services for each section of the highway along Corridor 10 that passes through our country.

As for railway networks, the Minister focused his discussion on the Belgrade rail junction only, stressing that about a half a million EURO have been invested in it so far and that it is necessary to provide another EUR 300 million for completion.

A number of investors are interested in this project.

Regarding gas lines, it is necessary to carry out the gasification of Serbia both for ecologic reasons and for better gas supply in all industrial centers. The preparation of project documentation is underway.

In conclusion, with regard to the issue of better telecommunications connections and better functioning of railway and road transport, it is important to connect local and international telecommunications junction. At present, activities on the creation of urban and technical plans for construction of main optical cables along Corridor 10 are underway.

Jasen Icev, director of the Bulgarian State Agency for Roads presented basic information regarding Corridor 10 on the territory of Bulgaria.

The total length of Corridor 10 passing across Bulgaria is 365 km. According to the Rehabilitation Program, about 60% of this length has been rehabilitated, while the remaining part will be completed by 2005, at the latest. About 190 km of highway that is part of Corridor 10, between Bulgarian and the Greek – Turkish border is constructed as a highway; 110 km of road construction remain between the Greek border and Thrace in order to raise this road to the level of a highway.

The Feasibility study for the part of the Corridor between the Yugoslav border and Sofia, in the length of 50km, has been completed and construction is projected for 2003 or 2004.

In conclusion, Mr. Icev pointed out that Bulgaria is crossed by sections of Corridors 4, 8 and 9, as well, and, according to the Rehabilitation Program, all these sections will be completed by 2006.

Iskra Boneva from the Ministry of Transportation and Communication of Bulgaria pointed to the great regional importance of Corridor 10 and the importance of Yugoslavia and Bulgaria as main transit countries for this corridor.

Ms. Boneva firstly presented some key objectives of the Bulgarian Government regarding the development of the transportation infrastructure. These objectives are as follows: to connect the Bulgarian transportation network with the pan-European traffic system; to complete the existing national infrastructure, with emphasis on networking with neighbors (there is no absence of infrastructure between Yugoslavia and Bulgaria); attention to the coordination of national programs of development with developmental plans for transportation infrastructures of neighboring countries; adjustment of national infrastructures with EU and NATO standards; promotion of environment-friendly transportation

systems and technologies (railways, combined transport, automated telecommunication and information technology for all types of traffic).

Ms. Boneva presented in detail the most important projects related to Corridor 10 on Bulgarian territory. These projects largely refer to the rehabilitation and modernization of railway infrastructure (including railway line Nis – Sofia), combined transportation and improvement, modernization and control of air traffic.

Bojan Borojevic from the Center for Liberal Democratic Studies presented the results of the “Regional Study of Transport Infrastructure In the Balkans”. The first stage of this study is complete (identification of main infrastructural projects), while the second stage is underway (identification of needs and capacities of each country for implementing these projects). On the basis of this study Mr. Borojevic pointed to the pivotal significance of Corridor 10 in the overall system of traffic communication in the region.

There are three key characteristics of Corridor 10 that constitute its pivotal importance to the entire network: geo-strategic position, since the Corridor follows the path of traditional communication routes along the Morava, the Sava, the Danube and the Vardar valleys; the existence and quality of transportation infrastructure already in place and the achieved level of traffic demand. The results of additional research (how to increase demand) indicate that demand could double by 2015. The analysis of supply and demand showed that sections on Corridor 10 that require intervention in the near future, in terms of capacity increase, are the Hungarian border – Belgrade section, and the Leskovac – Macedonian border section.

223 projects in the entire region applied for the study, out of which 39 projects on the territory of Yugoslavia applied – 20 on road networks, 11 on railway networks and the rest on air and waterways transportation. 32 projects were assessed as top priorities.

The implementation of all these projects at the regional level requires EUR 1.5 – 3.8 billion, while projects of first and second priority in Yugoslavia alone require EUR 1.4 – 1.5 billion. Yugoslavia can implement these projects in little over five years, given the allocation of 1.5% of GDP per year.

The second part of this study addresses the issues of investments and infrastructure funding in our country and in the region as a whole, Mr. Borojevic concluded.

Incentives to Economic Development and Integration Processes

On the second day of the conference, the third unit – i.e. incentives for economic development and integration processes – was opened by **Jovan Ratkovic**, national coordinator of the Pact for Stability of Southeastern Europe.

Mr. Ratkovic discussed Corridor 10 within a wider regional perspective, and pointed out some other complementary initiatives and projects that are planned for this region.

In April 2002, the Federal Republic of Yugoslavia assumed chairmanship over the process of cooperation of Southeastern Europe. Heads of states and

competent ministers of the region comprising this council make decisions on priorities for mutual cooperation. The following were defined as priorities: development of road transport (including the development of Corridor 10), the development of a single market for electric power, the development of common trade and trade liberalization, battle against organized crime and terrorism.

With regard to trade in particular, by January 1, 2003, Southeastern European countries will sign mutual agreements on free trade in order to establish the Free Trade Area of Southeastern Europe. This initiative should be realized in practice in 2003.

As for border crossings, the European Commission allocated some funds through the European Agency for Reconstruction and Development for the reconstruction of the Horgos border crossing. However, it is necessary to provide funds for the reconstruction and development of other, less frequent border crossings.

There is also a large project of the World Bank and the Pact for Stability of Southeastern Europe which refers to alleviation of transport across borders, acceleration of administrative procedure, crossing of borders, customs procedure, etc. This is very important for attracting investments and for simplifying commodity trade on Corridor 10. The World Bank will start implementing this project on the territory of Yugoslavia as of autumn. It is valued at US\$ 15 million. There is another regional initiative aimed at cooperation of countries in the region in attracting foreign investments. OECD, as the most active international organization in this initiative, releases a report at least once a year on all obstacles that still exist in some countries and that need to be removed.

In conclusion, Mr. Ratkovic addressed the issue of development and common initiative of countries in the region for the development of information and Internet technologies which are also very important for Corridor 10. One of the most important projects that should be carried out in our country regarding the Corridor is the construction of alternative optical infrastructure with 96 fibers and its connecting with the infrastructure of other countries along Corridor 10.

Branislav Andjelic, director of the Bureau of Informatics and the Internet in the Government of Serbia stressed that the Serbian Government has decided not to base the future of the country on old technologies, but to start developing the economy of knowledge.

There is an urgent need for telecommunications infrastructure through Corridor 10 which would connect optical junctions that already exist in Croatia, Hungary and Greece. This urgent need results from the lack of sufficient capacities for the transfer of all information from the 2004 Olympic games in Greece.

In order to make the best use of these opportunities for the development of the mentioned national strategy, the Agency for development of Informatics and the Internet has proposed the construction of one optical network of 96 fibers which would connect the biggest cities in Serbia through the corridor of public enterprises, as well as the construction of optical infrastructure in all towns by using public channels, which would enable optical cable links very near to beneficiaries in each town. That infrastructure could provide connecting of state

institutions, municipalities, and republic offices, i.e. the creation of an electronic government that needs rapid exchange of data in order to serve citizens.

Mr. Andjelic explained in detail how far this initiative has progressed, stressing that the feasibility study on technical and economic justification of this project has been completed. The project is valued at US\$ 60 million, but this investment could become feasible only if the network were used by public enterprises for their own telecommunications. The project would generate profit from the transit transport during the Olympic games, from renting the lines to Internet providers, while benefits relate to computerization of the whole of society and development of an economy of knowledge.

From the commercial and legal perspectives, this initiative would be carried out by setting up a separate joint stock enterprise that would be the owner of all these capacities. As far as the model of financing is concerned, there are several options: loans; private investors who would be granted an exclusive right to exploit a portion of the capacities in return for their investment; funding from the budget or from donations, as well as numerous other possibilities.

In conclusion, Mr. Andjelic stressed that speed is of utmost importance in this matter so as to make the best use of this advantageous moment, i.e. the 2004 Olympic games in Athens, and to generate considerable profit.

Branka Radovic, deputy to the director of the Privatization Agency of the Government of Serbia discussed guarantees offered to foreign investors in the privatization process, as well as guarantees provided to foreign investors under the Foreign Investments Law.

At the outset, Mrs. Radovic stressed that two main documents in the privatization process are contracts on the sale of capital and property by public tender and auction, as these are two basic methods of the sale of capital. These contracts are binding in a complex way. On one hand, the Privatization Agency appears as a holder of public authority which has been assigned by the Government of Serbia, and it concludes the contracts on behalf and on account of the Government of the Republic of Serbia; therefore, the Government is also the guarantor in these contracts, which is the ultimate guarantee to foreign investors; on the other hand, the Agency plays the role of an economic entity and takes on various obligations.

With regard to contracts on the sale of capital by public tender, the buyer does not take over any obligations, while all the guarantees rest with the Agency on behalf and on account of the Government of Serbia. Guarantees refer to the legal status of an enterprise, its ownership, financial performance and the fact that all data produced in the tender documentation are authentic, etc. The Agency also commits to providing regular business performance of the privatization subject until the buyer becomes a factual owner.

As concerns public auction, guarantors are both the Agency and the entity which is being sold.

If it reneges on any guarantees or obligations that it assumed, the Agency is obliged to compensate damages which were suffered by the buyers as a consequence of statements made, with the damages being limited both in terms of time and value.

Legal environment that insures safety to foreign investors is defined in the Foreign Investments Law and other special regulations that either directly or indirectly regulate this area. In conclusion, Mrs. Radovic gave a detailed description of what is actually offered to foreign investor by this legal framework, in particular with regard to safety and incentives.

Dragan Domazet, Minister of Science, Technology and Development in the Government of Serbia discussed the plans of his Ministry for establishing the zones of technological development along Corridor 10.

The Ministry for Science, Technology and Development has projected four technological zones which would primarily support Greenfield investments and would be located in towns with universities, institutes and the most qualified human resources – Novi Sad, Belgrade, Kragujevac, Nis. The zones of technological development would have scientific and technological parks for the transfer of knowledge and the transfer of technology from the area of research and development to the area of development of industrial products and services for the market.

At present, the establishment of two scientific and technological parks / lots is projected in Belgrade and in Nis; at a later stage, similar proposals will be considered for Novi Sad and Kragujevac.

The state would construct only basic infrastructure in these parks which would fit into world standards. Care for these parks would be assigned to a separate enterprise that is yet to be founded, while construction within the parks would exclusively depend on business interests of investors. The premises would be used for the development of various companies, in particular for the development of service industries, R & D centers, project organizations, information technologies, software, etc.

These parks will enable greenfield investments that are of interest for both foreign and local companies, i.e. they allow the installation of developmental plants, educational centers, logistical centers along Corridor 10 that could be transformed into the backbone of development not only of Serbia, but of the Balkans as a whole, Mr. Domazet underlined.

The realization of technological zones of development with scientific and technological parks is a long-term action which requires prudent preparation, is strategically oriented, and aims at setting up a completely new industry, Mr. Domazet concluded.

Discussion

Aleksandar Cvetanovic, professor at the Faculty of Civil Engineering in Belgrade, stressed that Corridor 10 is a great opportunity for our country which should be exploited in a clever and economical way. This is also a chance for the whole region to get together and increase its chances for rapid accession to the European Union.

The role of this Corridor is to connect the East and the West. The network of highways of this rank has been constructed in the whole of Western Europe, and is being constructed intensively in Asia, and is aimed at connecting Europe and

Asia. A bottleneck, as professor Cvetanovic stressed, is this region, in particular our country, Macedonia and Bulgaria.

Professor Cvetanovic presented technical details regarding Corridor 10, the portion of it passing through our country, how much has been done and how much still remains to be done, as well as problems concerning particular sections.

In professor Cvetanovic's opinion, at present, Corridor 10 is the most profitable project in this region and can be our most important exporting product. Corridor 10 is a very profitable investment, since after ten years of exploitation it will generate pure profit. The advantage is that it is not necessary to build both lanes of the highway since the expected level of traffic circulation is not such as to justify such construction; consequently, the exploitation period of pure profit can extend further.

What should be carried out immediately, as far as the Government is concerned, is to set up or to provide at least one bank that would follow the entire implementation of these and similar projects, professor Cvetanovic concluded.

Rajko Tomanovic, assistant to general manager for development of the Petroleum Industry of Serbia (NIS) pointed to the need to establish durable communication between the future public enterprise of Corridor 10 and other related activities. Mr. Tomanovic warned of disproportion between what NIS can do and plans to do it in the upcoming period within its investment and development program, and what came up at the conference (oil pipe line, gasification, filling stations and other transitional services, links in scientific and developmental parks). For all these reasons coordination of activities is necessary, Mr. Tomanovic concluded.

Dragi Marjanovic, from the Faculty of Civil Engineering, Belgrade, using concrete examples, tried to point to the specific characteristics of two patterns of financing of infrastructural projects (railways in particular) – budget funding and partnership of public and private sectors. Mr. Marjanovic stressed that although budget funding is an outdated form of financing, it nevertheless has certain advantages over private financing. Budget funding allows stricter control both with regard to spending of taxpayers' money and in terms of control of quality of works at all levels; and the state is the guarantor of quality. The latter financing pattern, tending to reduce costs, does not ensure such control neither with regard to planning and design, nor to performance of works, whereas the quality of the performed work is guaranteed by contractors.

All these specific characteristics result in variations in the time necessary for works to be completed. Given that the main emphasis is on safety and quality, the former model requires a longer completion period (in the concrete example, as long as 16 years), while in the latter, equal emphasis is put on safety and the term of completion, and takes much shorter time to finish (five years).

Mr. Marjanovic does not advocate either funding pattern, but wants to point out specific characteristics of both in order to avoid oversights in the future.

Milivoje Zunic, from the Postal Service of Serbia noted that as far as telecommunications are concerned, the idea of Corridor 10 is not new. Ten years ago, there were two European projects that promised our country connection to

the world of telecommunications and modernization of our telecommunications network.

The first project was supported by the International Union for Telecommunications, in which many countries from this region participated. Although this project was based on telephone communication, since the Internet was just emerging, the results of the study showed that it was absolutely profitable.

The second project, largely funded and supported by the American company "US West", foresaw the construction of a telecommunications highway between Istanbul and the North Sea, and was profitable under conditions at that time.

Although we missed that opportunity through our fault, the project of Corridor 10 today is even more attractive in terms of telecommunications, Mr. Zunic concluded.

Dragomir Mandic, professor at the Faculty of Traffic Engineering stressed that the Faculty of Traffic Engineering of the University of Belgrade, in association with the Aristotle University from Thessalonica, made a significant contribution to justifying the reasons for Corridor 10 to be included in the network of pan-European corridors in 1997. A joint study of Corridor 10 showed that the traffic volume that currently circumvents Yugoslavia passing across Romania and Bulgaria should be expected, along with transit traffic that goes from Germany and France by ferryboats, through Italy to Greece.

Professor Mandic stressed that, as soon as the highway infrastructure on the Corridor has been completed, new problems will emerge, resulting from external costs (traffic jam, pollution, etc.) and the need for new projects – the improvement of railway infrastructure, which is associated with much lower costs. Foreseeing such development of events, professor Mandic pointed to ongoing research and definition of strategy that should answer questions as to what is the best way to improve railway infrastructure.

Edward Hoffman from the Policy Legal and Advice Center stressed that Corridor 10 is an interesting and complex project. Therefore, in Mr. Hoffman's opinion, such a project cannot be managed from one center. It should involve as many people as possible, an enterprise that will contribute to implementation, and not wait for one grand plan that will appear in several years. It is necessary to create conditions for liberating the economy and encourage all actors to enter this process and have strength and desire to hold out to the end.

Dragan Domazet, Minister for Science, Technology and Development in the Government of Serbia, informed participants that the Serbian Government set up a Commission, headed by the Prime Minister, with many ministries as members. The newly-established Council and its numerous working bodies will work on the harmonization of all regulations and on the reorganization of the Government, so as to achieve a compatible level, in terms of capacity and working methodology, with the governments of EU member states. Consequently, in all ministries activities have taken that direction, in order to prepare for cooperation with EU member states, Minister Domazet concluded.

Conclusion

All participants jointly evaluated the conference as successful, both in terms of organization and issues discussed, as well as in terms of offering basic guidelines and framework for future activities of all potential participants in Corridor 10.

There is general agreement that this project concerns an enormous and complex challenge, as well as large-scale investment and an opportunity for the region as a whole. Corridor 10 should be a backbone of economic and every other development of Serbia and Yugoslavia, symbolizing the beginning of the transition to a completely new approach to the implementation of projects, which is based on the partnership of private and public sectors, and setting the groundwork for an investment and institutional framework for non-administrative burdening of future business performance in our country. At the same time, Corridor 10 is a hope for the entire region to unite in peace in every respect, and to increase its chances for faster accession to the European Union as a single entity. This conference is the first in a list of conferences dealing with specific issues concerning Corridor 10, signifying a strategic step of sorts. Participants were very enthusiastic and optimistic that many concrete activities will be completed by the next conference.

The G 17 Institute, as one of the participants and organizers of this international conference which is very important for our country, once again confirmed its commitment to support all project of strategic and developmental importance, both in terms of organization and expert contributions.

Reform of the EU and the Commission – Constitution for a New Europe?

After the period of stagnation during the 1960s and 1970s, the European Union has made significant progress at the end of last and at the beginning of this millennium. A new successful period began with the adoption of the Common European Act (1987) and with the introduction of the single market. Actually, a new period of integration started with the completion of the single market and with the adoption of the Maastricht Treaty in 1992. This Treaty established both the European Union and its organizational and institutional structures and principles of cooperation in the area of foreign affairs and interior security, which was completed in the structure of “three pillars”. Subsequent changes of Founding treaties, the 1997 Amsterdam Treaty and the 2000 Nice Treaty, although having slowed down the then accelerated pace of integration, set the groundwork for general adjustment to the new issue that emerged in the Union – i.e. enlargement. Enlargement as a process requires significant changes in the work of particular offices in order to maintain the functionality of the enlarged Union under conditions of increased external challenges resulting from the process of globalization, and to further its capacity of internal action. Alongside enlargement, the Union continues to face the problem of “closer union of the European peoples”, i.e. the issue of deepening integration.

How is the EU tackling this duality of challenges which seems irreconcilable, what are the basic questions it faces and what are the proposed solutions?

The priorities of reform were presented in some very important documents of the Union: primarily, this refers to the Declaration of the Future of the EU as an integral part of the Treaty adopted in Nice (December 2000) and presidential conclusion of the Summit of the European Council held in Laeken a year later. Five groups of fundamental questions, which are the focal point of EU reform, stood out according to these documents .

The first group of questions refers to the structure of the treaties on founding three European Communities and the European Union, as well as to amendments of these treaties that have been carried out so far. Constant changes of the Treaty brought about proliferation of various instruments; at the same time, it should be borne in mind that directives (as the most common form of decisions, which are binding in terms of their objective, with member states being free to choose the most appropriate means of implementation) have gradually become designed as more detailed legislation. That is why the main question is how these treaties could be simplified without changing their basic content. The essence of this question is the search for a solution for better organization of these treaties and their simplification.

On the other hand, an important question refers to the Charter on Fundamental Rights, which was proclaimed in Nice, although without a precisely defined legal status. This results in the dilemma whether the Charter will become an integral

part of the Founding Treaties or whether it will be interpreted as a declaration (i.e. a non-binding act). In the first case, incorporation of the Charter into the Founding Treaties would mean that protection of the rights proclaimed in this Charter is legally binding to both Member States and the Union, being in the jurisdiction of the chief judicial institution in the Union, and the EC Court of Justice. In the latter case, the Charter of Fundamental Rights would remain an expression of commitment of member states and of the Union as a whole to the rights laid down in the Charter, while the protection of these rights would remain under the competence of member states (and the European Court for Human Rights of the Council of Europe as the final instance).

The second group of questions concerning reforms in the EU refers to the sharing of power between the Union and its member states. Namely, this refers to finding a way to organize this sharing of power. It is considered very important in this case to explain, simplify and adjust sharing of power, at the same time as taking care of increased transparency. The main objective is to draw a clear line between three groups of powers: exclusive powers of the Union, the powers of Member States and common powers of the EU and member states. The objective is to enable these powers to be pursued most efficiently. Special attention, however, must be paid neither to increasing the powers of the Union nor to returning powers to member states, namely, not to reorganize the sharing of powers, but to define them more clearly and to organize precisely their mutual relation.

The third group of questions refers to the institutional balance between the main institutions of the Union: how to organize this relation between corresponding powers of each institution, but at the same time, owing to the rapid and inevitable enlargement of membership, to resolve the problem of their efficient work. This question comprises two basic elements: firstly, whether the Union can be democratized by strengthening the role and authority assigned to institutions that represent the interests of the Union and its citizens, and not of member states (such as the European Parliament and Commission); and secondly, internal reorganization of work of each institution, simplification of the decision-making procedure and division of votes (in case of weighing of votes) so as to leave space for new members, but not to imperil the decision-making procedure itself.

The issue of efficiency of internal activity of the Union comprises the forth group of reforms-related questions. The key element requiring an answer is what could be the guarantee of coherence and efficiency of EU work in international relations that is in line with Common Foreign Policy and Safety. Namely, whether the Union is capable, or even competent, of undertaking measures that would eventually lead to one vote of the EU in international relations, international organizations and the tackling of crises. This does not concern "communitisation" of foreign policy, or the attempt to make the policy towards third states "inter-state" by expending the powers of member states. This concerns proposals for real responses to requirements for coherency (through the creation of a center that will control political initiatives and articulate common interests) and the requirements of efficiency (through adjustment of procedures that would comply with specific characteristics of foreign policy). Gradual incorporation of the duty of

High Representative of the EU and the Commissioner for Foreign Affairs is foreseen as one of the ways of fulfilling these requirements. Powers thus incorporated would give legitimacy to the leading role in tackling crises. Foreign policy should contain all necessary elements for its successful pursuance: a budget, new procedures, a network of external branches, while decisions would be made through decision-making by majority, except in the case of procedures concerning security and defense (where unanimity must be maintained).

The fifth question concerns the Union getting closer to its citizens – how to strengthen democratic legitimacy of the Union and what are citizens expecting from the Union. The issue of legitimacy of the Union is one of the most interesting issues in a political sense. Namely, the EU does not draw its legitimacy from democratic values referred to as European, objectives it wants to attain and its powers and the means at its disposal. Therefore, an important question has been raised as to how to include EU citizens in this whole issue, since they do not comprehend this construction as their own. One possibility is to strengthen the role and participation of national parliaments, whose place in the European integration process is yet to be discussed, but which will by all means be significant for the creation of the emerging European public space.

However, the ultimate question is whether the Union can (and even whether it should) get its Constitution. As of the mid-1970s, this has been among the most favorite topics at all debates on both the future of the Union, and on its present character. The entire debate was initiated by the EC Court of Justice through the definition of the Founding treaties of the then three communities as “constitutional charters”. The issue of the need to adopt the EU Constitution actually concerns the problem of defining its character – with a constitution, it is a state; without one, it is nothing more than international organization, however specific it may be.

It seems that the one of key institutions of the Union – the Commission – has clearly supported the adoption of a constitutional text. A similar position has been expressed recently in a speech given by the President of the Commission, Romano Prodi (the speech delivered in Milan of July 15, where Mr. Prodi presented the Commission’s view on certain issues of EU reform). In Mr. Prodi’s opinion, besides the need to simplify existing provisions of various treaties that were adopted before, it is necessary to do something more. Namely, the Treaties which set up the Union and the three communities does not define some issues directly and precisely, but rather in reference to the member states’ constitutions. These issues primarily concern the legitimacy of the Council and the Commission (since the composition of these institutions reflects the citizens’ will only indirectly) and the protection of fundamental rights which are legally guaranteed only in member states’ constitutions. Therefore, the EU constitution would first have to define the legal groundwork of the Union itself, its main tasks and principles, the institutions in charge of implementing these tasks and the respect of the rights of the Union’s citizen.

Mr. Prodi points out that “...since the EU is a union of states and peoples, while governments are still the masters of treaties... the most likely outcome of reforms is the creation of a constitutional treaty.” Mr. Prodi bases this opinion on the

proposal adopted on May 22, 2002 by the Commission, under the title *Project for the European Union*, a document containing the Commission's proposals that are supposed to serve as basis for change of the institutional system of the Union. With this proposal, the Commission gave its contribution to the work of the Convention on the Future of Europe which is aimed at dealing with institutional reforms geared toward defining the main tasks of the Union and the constitutional framework which should be taken into consideration by the Convention during its work.

The Commission presented some very interesting proposals regarding changes to the founding treaties on which the Union is based today. Their complexity which results from frequent amendments during their 50-year history, is seen as the main reason for confusion and inconsistency, nevertheless allowing the Union to work efficiently. To simplify and rationalize institutional architecture of the EU, the Commission suggests the incorporation of the EU Treaty and the treaty on foundation of communities, which would wipe out the distinction (an outdated distinction in Commission's opinion) between the area of the Community (first pillar), areas related to common foreign policy and security (second pillar) and police and judicial cooperation in criminal matters (third pillar). Thus, the Union would get a unique character of legal entity; at the same time, this does not mean that the community method would be applied in the same way on areas that comprise the second and third pillar, but the role of institutions and the decision-making procedure applied in them would have to be clearly defined by the Treaty itself.

Through a combination of all these proposals, the Commission believes that the Union would get the act of constitutional nature – a constitutional treaty, which would exist alongside national constitutions and which would codify the specific organization of European public authorities in a uniform way, but at the same time would be comprehensible for all, bearing the same values as the constitution of any member state. The Commission, however, is aware that this would raise the question of ratification of such an act, as well as prompting an even more significant question concerning consequences if ratification fails. At this time the Commission does not offer any answers to these perplexities.

The EU Review

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EU NEWS

The Enlargement of the Union

These days the EU 15 have started discussion on the budgets of new member states. The Commission proposed the obligations for the Czech Republic, Slovenia, Cyprus and Malta to pay compensation which exceeds what these countries are going to receive from the Union in the course of 2004.

Thus, the budgetary issue is becoming a new sticking point, raising a range of questions related to the enlargement of negotiations.

Anyhow, the decision on the time of enlargement should be made during the Danish presidency over the Union. That decision is scheduled for adoption at the Copenhagen Summit in December.

The Financial Times, September 12, 2002

Agriculture

Since the election in Germany is over, the decisions on important issues in the area of common agricultural policy of the EU, which have been under discussion for a while, are likely to be made in October or November. The meetings which were held during this year, in particular those held in July and September of this year, symptomatically focused general issues, while the essential ones were postponed until autumn, awaiting the election called for September 22. Three significant issues have to be resolved by the year-end: enlargement negotiations with candidate countries (the EU 15 is supposed to agree on a financial arrangement that will be offered to these countries for the period 2004 – 2006); the reform of common agricultural policy and the budget for the period 2007 – 2013.

Brussels, September 11, 2002

Food Products – Food Imports in the EU

As of January 1, 2003, travelers entering the Union from third states will not be allowed to bring milk and meat, and meat and dairy products in their personal luggage into the territory of the European Union, unless they are issued a special permit by authorized sanitary officials.

Tight control of fish and other products entering the EU from China, Vietnam and Pakistan is scheduled to end.

However, new tests on the presence of antibiotics in natural and artificial milk which enters the Union from Ukraine are being introduced; this also refers to certain types of meat exported from Brazil.

This regulation has not been released yet in the EC Official Gazette.

Brussels, September 20, 2002

Information Technologies and Telecommunications

A conference on information technologies and telecommunications in the EU was held in Estonia; this conference addressed plans for the period 2002 – 2005.

The EU telecommunications policy aims at providing high quality services at low prices in order to make them available to all European citizens.

The new legal framework for electronic communications, which is much more flexible than the current one, is scheduled to come into effect as of 2003. This should contribute to better market competition on the single market. To avoid its fragmentation, appropriate regulations are to be adopted at the national level alongside actions taken at the level of Community.

Brussels, September 20, 2002

Environmental Protection

LIFE Project

The Commission has selected 109 new projects that will be funded within the LIFE project. This project is aimed at collecting necessary knowledge and experience in order to start the creation of appropriate legal regulations, both in Member States and in Candidate Countries.

Total funding amounts to about EUR 213 million, out of which EUR 69 million will be provided by LIFE.

The majority of projects refer to water resources and long-term regulation of this issue, liquid waste treatment, the protection of ground waters and administration of river basins.

Selected projects cover five areas: the incorporation of environmental protection into the strategy of territorial development and regulation and urban administration, long-term administration of water resources, prevention, recycling and the reuse of liquid waste, the assessment of impact of economic activities on the environment and the promotion of a common policy in this area at the level of the Union.

Labeling of Detergents and Protection of the Aquatic Environment

The protection of the aquatic environment and the labeling of detergents are legally regulated in the EU for the first time in September 2002. The adopted regulation concerning detergent labeling introduced the obligation on the part of manufacturers to supply information on the chemical contents of detergents on their labels. The new regulation also includes a stricter testing method which now test the final, rather than the primary biodegradability of detergent surfactants.

This is considered to be better protection of both the environment and of consumers.

The regulation has not been published yet in the EC Official Gazette.

Midday Express, September 20, 2002

Sixth Environmental Protection Program

The EU Decision no. 1600/2002/CE stipulates the inclusion of environmental protection into all policies of the Union. This is one of the measures of the Sixth Environmental Protection Program, which started on July 22, 2002 and is scheduled to last at least ten years.

Although it is considered that the best results will be achieved only when public awareness of the importance of environment changes, the legal framework will certainly prompt some concrete actions.

The areas which require urgent intervention have been defined, as well. It is necessary to reduce the green house effect as soon as possible, which will be achieved through the reduction in the emission of harmful gases. This primarily refers to the reduction in the concentration of exhaust gases to a level that is considered harmless.

The monitoring of the implementation of the project is planned every four years.

EuropaLex, September 24, 2002

Packaging Recycling

On September 3, the EU Parliament gave a positive opinion on the Commission's proposal of a new version of the Directive (Instructions) no. 94/62/CE on packaging and packaging waste. The Parliament proposed some changes which referred to the prevention, reuse of used materials and the responsibility of manufacturers.

This Proposal foresees much stricter standards for the collection and recycling of packaging.

This is aimed at improving the general level of environmental protection.

The regulation has not been published yet in the EC Official Gazette.

Pan-European Corridor Italy – Turkey, Through Albania, Bulgaria, Macedonia and Greece

With agreement of the EU Transport Ministers, and in the attendance of representatives of Albania, Bulgaria, Macedonia, Greece, Italy and Turkey, and of the EU Commission, as well, on September 9, 2002 the Memorandum on Understanding on the international pan-European corridor VIII was signed; the corridor will link Italy and Turkey, passing across several countries. This Memorandum will facilitate cooperation between countries in question on the creation of the joint project. The document that was signed at this ceremony will provide for flexible and appropriate structures, as related to ten other pan-European corridors.

Midday Express, September 10, 2002

Petroleum and Gas Supply

On September 11, the Commission adopted two proposals for directives which will contribute to improvement in safety in the procedure of energy supply.

The Community's mechanisms concerning energy supply that went into effect at the beginning of the 1970's proved inadequate for today's challenges, and it is therefore necessary to initiate certain changes.

All member states are supposed to set up a public oil stockholding body, which will eventually own stocks representing at least 40 day's consumption. Furthermore, stocks will be established for the EU as a whole in case of a crisis that could affect the whole Community for 90 day's consumption; these stocks would be used in the context of solidarity according to established order.

Member states will define general policy with regard to gas supply, together with the appropriate safety standards. Certain solidarity mechanisms in the case of a crisis are also provided.

This new community framework will entail the accomplishment of complex technical tasks concerning monitoring of trends on international oil and gas markets, evaluation of their impact and safety of supply, as well as the monitoring of reserves.

This regulation has not been published yet in the EC Official Gazette.

ECONOMIC NEWS

Instead Of Declarative Statements, Commitment To Structural Changes Is Necessary

The formation of the Economic and Monetary Union (EMU) has created a framework for economic policy-making which is unique in history.

On one hand, there is a single monetary policy oriented towards a Union-wide objective, namely the maintenance of price stability. The responsibilities for most other economic policy areas, in particular fiscal and wage policies, largely remain at the national level.

This asymmetry has led some observers to call for a greater degree of economic policy coordination among EMU members. However, as professor Otmar Issing, a member of the executive board of the European Central Bank (ECB), stresses, it is not always clear what is meant and intended by such statements.

The present macroeconomic framework already contains various elements of coordination of economic policies among member states. The set of agreed medium-term targets and surveillance procedures for national fiscal policies prescribed by the Maastricht Treaty and the Stability and Growth Pact (established in order to maintain the criteria on the convergence for the entry to the EMU within the framework set by the Maastricht Treaty) represent a systematic and rules-based form of economic policy coordination. Enhancing coordination in the field of fiscal policy could mean either strengthening effective implementation and enforcement of decisions or more ad hoc discretionary attempts by governments to react to common economic and political pressures. Of course, the latter option may easily result in the weakening of the underlying framework of coordination.

In the field of structural, social and employment policies the less stringent, so-called "open method" of coordination puts a lot of emphasis on learning from each other, benchmarking and identifying best practices. Enhancing policy coordination in these fields could mean speeding up reform action in a way best-suited to local circumstances, which would result in ill-fated attempts to harmonize or impose common standards prematurely.

In view of everything advanced thus far, there are no convincing arguments favoring the need for or desirability of further macroeconomic policy coordination in the Euro--zone.

By contrast, any form of ex-ante coordination of policies between the European Central Bank and other actors at the national or European levels would be inconsistent with the ECB's mandate, its independence and its credibility, which were codified in the Maastricht Treaty. Naturally, independence does not preclude an ongoing exchange of views, information and analysis, but the attempts that go beyond this practice create the risk of confusing the specific roles, mandates and responsibilities of the policies in question.

In professor Issing's opinion, macroeconomic policies, in any case, cannot resolve the underlying structural causes of Europe's growth and employment problems. Only structural changes aimed at the micro level can tackle the roots of the problems, and can thus contribute to higher growth and more favorable employment prospects in Europe. On the occasion of a number of EU summits, especially those in Lisbon and Barcelona, European leaders have committed themselves to structural reforms; time is now ripe to translate these intentions into action.

Overall, the Maastricht Treaty provides a sound allocation of responsibilities and a solid basis for economic policy-making in Europe. In professor Issing's opinion, the present set-up has worked very well and changes are not required. What is needed instead is a continued and increasing commitment to playing by the established rules. This applies, in particular, to full and effective implementation of the Stability and Growth Pact by all governments, since a credible framework for sound public finances is an essential complement to lasting monetary stability that is safeguarded by ECB. Weakening either of these central elements of the macroeconomic framework – under the cover of increased policy coordination – would endanger the credibility of EMU, as professor Issing concludes.

EU Enlargement Process And The Necessity Of Reform In Common Agricultural Policy

Given the upcoming process of enlargement of the European Union, the need for reform of common agricultural policy (CAP) is becoming increasingly urgent; at least direct payments to farmers must be gradually reduced.

At present, CAP accounts for 45% of the total EU budget. The ten CEE countries currently negotiating for membership would increase the number of farmers by 120% and the area under cultivation by 42%. Consequently, the cost of the CAP is expected to increase dramatically.

There are three categories of agricultural expenditures in the European Union. In 2000, more than EUR 10 billion, i.e. 12% of the total EU budget, was spent on so-called "agricultural market interventions", supporting EU farm prices through purchases, storage and export subsidies. Another EUR 4.2 billion was spent on rural development, a variety of programs now referred to as the second pillar of the CAP. However, by far the largest budgetary items are direct payments or compensatory payments introduced over the past decade to compensate farmers

for price cuts implemented in connection with reforms of the CAP. In 2000, the EU 15 spent EUR 25.6 billion on direct payments, which accounts for almost 30% of the total EU budget.

Direct payment expenditures will grow even further with the full implementation of Agenda 2000, the financial framework agreed at the Berlin Summit in 1999, although this assumed that only six new member states would join by 2002 and that their farmers would not qualify for direct payments. Under these assumptions, agricultural expenditures for new member states were capped at slightly below EUR 3 billion by 2004 and EUR 4 billion by 2006.

The situation today is completely different, given that ten new members will join, and the first accession will take place only in 2004; more importantly, their farmers are likely to receive at least some direct payments from the moment of accession. There is much opposition in member states against extending direct payments to CEEC farmers, but all the candidate countries are united in their insistence on getting the same subsidies as EU 15 farmers, including direct payments, from the moment of accession.

Numerous studies of the cost of extending the CAP to the CEECs have been made. Under the scenario that CEEC farmers also get full direct payments from the moment of accession, additional CAP expenditures will be significantly larger than the amounts foreseen in the Agenda 2000 financial framework. With eight CEECs (i.e. not Bulgaria and Romania) set to join in 2004, agricultural expenditures will increase by around EUR 10 billion in 2007. Around 60% of this amount will go toward direct payments, with market expenditure and rural development each accounting for around 20%. After the accession of Romania and Bulgaria, spending will increase to around EUR 14 – 15 billion.

The solution for enlargement which fits the financial framework foreseen in Agenda 2000 is feasible and was proposed by the European Commission last February. According to this plan, the CEECs would receive the equivalent of 25% of EU – 15 direct payments in 2004, 30% in 2005, 35% in 2006, progressively rising to 100% in 2013. Under this formula, additional expenditure on the CAP would be around EUR 3.9 billion in 2006, which fits the financial framework. Yet, even if the EU manages to “fit” the enlargement process in the 2000 – 2006 financial framework, this does not distract from the fact that, in the absence of reform, expenditure will anyhow in the years after 2006 run up to EUR 15 billion.

To get a feeling for the relative size of the subsidies, it should be noted that agricultural GDP in ten CEE countries was less than EUR 18 billion in 1999. Hence EUR 15 billion of EU budget support would amount to more than 70% of the 1999 agricultural GDP in all CEECs. Of course, it should be borne in mind that total support for agriculture in these countries is even higher because of non-budgetary transfers from consumers through price and trade interventions. A rough estimate of the non-budgetary transfers to CEEC – 10 farmers with accession would add another EUR 5 – 10 billion in addition, which means, in total, that the expected CAP transfers to CEEC farmers may be larger than the GDP generated by agriculture in those countries.

All this suggests that a reform of CAP, and of direct payments in particular, is necessary. Reducing the budget costs of the compensation payments can be

done in several ways: by limiting them over time (“degressivity”), by limiting the amount per farm or linking them to the size of the farm (“modulation”) or by a combination of the two, as is suggested in the mid-term review proposals of the European Commission.